

BRITISH RETALIATION AGAINST THE CALIFORNIA UNITARY TAX: THE NEEDED IMPETUS FOR A FEDERAL SOLUTION

Robert D. WALLINGFORD *

The worldwide unitary tax imposed by California on foreign corporations has provoked general international concern, as well as specific retaliatory action by Great Britain. This Comment explains how the unitary tax affects foreign corporations and the various proposed state and federal remedies. A carefully drawn federal repeal of the unitary tax would eliminate the British retaliation while allowing the U.S. states maximum flexibility to determine their own tax policies.

1. Introduction

On July 9, 1985, the British Parliament passed legislation [1] enabling the British Treasury to retaliate against United States corporations because California, as well as five other states [2], impose a worldwide unitary tax [3] on multinational corporations. The unitary tax has stirred wide international controversy since California [4] consistently began applying its Bank and Corporation Tax on a worldwide basis in the 1970s [5]. Fourteen member countries of the Organization of Economic Cooperation and Development (OECD), accounting for nearly ninety percent of foreign direct investment in the U.S. have opposed the unitary tax [6].

Great Britain objects particularly to the California method of worldwide unitary combination. This method subjects the net income of the British parent and all subsidiaries to apportionment by the state where one subsidiary is located [7]. Worldwide unitary combination not only indirectly taxes the British parent but creates double taxation for the corporation [8].

As a result of the British retaliation and other international protests against the unitary tax, many U.S. officials believe that the unitary tax on a worldwide basis should be eliminated [9]. Considerable disagreement exists as to the form any repeal legislation should take and whether repeal should come from the federal or state governments [10].

A California legislative repeal of the unitary tax would be one possible answer to the British retaliation. Other states have yielded to the international

* J.D. Candidate, 1987, University of Pennsylvania Law School; M.B.A., 1978, Pace University; C.P.A., formerly staff auditor with Price Waterhouse & Co.

pressure and have repealed [11] or refused to enact [12] unitary tax legislation. California has also repeatedly considered repeal: several proposals failed to pass in the most recent legislative session ending September 13, 1985 [13]. The recent California proposals illustrate the problems in relying on a California solution, which may not necessarily be as comprehensive or timely as sought by Great Britain [14].

A federal response to the unitary tax problem has been recommended on several occasions [15]. The US–UK Bilateral Income Tax Convention (US–UK Convention) as originally drafted would have prohibited any U.S. state from applying a unitary tax to any British corporation [16]. The U.S. Treasury Department (Treasury) has proposed federal legislation which encourages, although it does not require, the states to cease using the unitary tax [17]. The Treasury proposal would also permit the application of the unitary tax to the foreign home-office of a U.S. branch [18]. This Comment suggests a federal solution based on the Treasury proposal, including a federal prohibition which would prevent application of the unitary tax to the operations of any foreign corporation outside the U.S., including the home-office of a U.S. branch. Such a modified federal solution would offer a consistent limit to the application of the unitary tax and would eliminate the British retaliation [19].

In Section 2, the British retaliation and the impact of the unitary tax on British corporations is examined. In Section 3, recent California repeal legislation is evaluated as a potential state solution to the unitary tax problem. The Supreme Court's decision in *Container Corp. v. Franchise Tax Board* [20] upholding the California unitary tax is discussed briefly. The federal solutions offered in the original US–UK Convention and the Treasury proposal are analyzed in Section 4. The Comment concludes that federal legislation, including a direct prohibition of the unitary tax, would best solve the problems posed by the British retaliation.

2. British Retaliation Against the Unitary Tax

2.1. Analysis of the British Retaliation

After exhaustive political efforts to persuade states to repeal their use of the worldwide unitary tax [21], the British Parliament passed New Clause 27 to retaliate against corporations that do business in unitary tax states [22].

New Clause 27 denies refunds of Advance Corporation Taxes (ACT) to U.S. and other foreign corporate shareholders by the British Inland Revenue (British equivalent of the Internal Revenue Service) [23]. When the US–UK Convention was signed in 1975 [24], a key benefit desired by the U.S. negotiators was to allow U.S. shareholders of United Kingdom (U.K.) corporations to obtain a refund of ACT, as did U.K. resident shareholders [25].

Under the original US–UK Convention, the U.K. was required to refund ACT to all U.S. shareholders whether or not residents of the U.K. [26] Prior to the retaliation, U.S. corporate shareholders received a refund of approximately 15% to 17.5% of their original dividend as a refund of ACT, depending on the percentage of shares owned in the U.K. corporations [27].

The retaliatory legislation affects any group [28] of companies that has more than 7.5% of its property, payroll, or sales in a unitary tax state [29]. The concepts of property, payroll, and sales are the same factors used by the unitary tax states to apportion corporate income, but in New Clause 27 the factors are used in the alternative. Therefore, if a corporation has the required percentage of property, payroll, or sales in a unitary tax state, it will lose all ACT refund benefits.

The legislation also includes a retroactive provision: any ACT refunded to a shareholder after April 1, 1985 would have to be repaid with interest to the British government at double the amount actually received [30]. The interest due on any repayment is meant to be a non-deductible penalty [31]. U.S. corporations face potentially huge losses of ACT as well as double payments of past ACT refunds [32].

The debates in Parliament are unclear as to how the retaliation would result in repeal of the unitary tax. Mr. Grylls thought the bill would cause U.S. companies to “press and lobby hard their *state* . . . and *federal* government[s] to . . . clear up the issue of the unitary tax” [33]. Ironically, the very companies suffering under the unitary tax are already highly motivated to lobby with their governments for repeal [34].

One effect of the legislation is the potential change in bargaining position of companies lobbying to repeal the unitary tax. Although most U.S. corporations are opposed to the unitary tax, they are also potentially against repeal until the legislation includes certain other provisions they favor. Under this theory, the retaliation would provide the needed impetus for U.S. corporations to drop their insistence on linking repeal to their own legislative goals.

New Clause 27 does not make clear whether a state or federal solution is desired. By using a 7.5% factor, the legislation is intended to affect corporations in California most directly [35]. Mr. Grylls indicated that either a federal or a state solution would be satisfactory, but that a federal solution would be best [36].

2.2. Effect of Worldwide Unitary Apportionment on British Corporations

Worldwide unitary apportionment is one method of determining the income of a multinational corporation (MNC) subject to a state's tax [37]. Under this method the total worldwide income of all corporations deemed part of the same unitary business is apportioned to the state by the use of a multifactor formula [38].

The definition of a unitary business has created significant controversy [39].

The definition used by each state is the result of “[f]ormal laws, regulations, and judicial rulings [which] ... are generally vague” [40]. California has adopted three criteria which determine when apportionment should include the net income and apportionment factors of a related business: unity of ownership, unity of use, and unity of operations [41]. Once a business qualifies as unitary, all parts of the business are included in the apportionment formula. The inclusion of the related or affiliated entities in the report of the corporation subject to the tax is called combined reporting [42].

The multifactor formula generally consists of the average of the ratios of the in-state property, payroll, and sales to out-of-state (and out-of-country) factors [43]. To illustrate, suppose a British corporation with subsidiaries in California, Maine, and Canada was deemed to be conducting a unitary business in California. The California apportionment formula would be the average of the three factor ratios. The ratio for each factor would include the total dollar amount of that factor attributable to the California subsidiary as the numerator and the total of the California, Maine, and Canadian subsidiaries and the British parent factors as the denominator. The apportionment formula is then multiplied by their combined taxable incomes (defined under applicable state law) to yield the net income subject to tax in that state.

In the above example, inclusion of the British parent and the Canadian subsidiary means that California has applied the apportionment on a *worldwide* basis [44]. Some states apply worldwide combination to only U.S. corporate parents, and not to foreign parents, a practice called *domestic worldwide* combination [45]. In general, the term worldwide unitary taxation includes both of these methods.

Other states apply unitary apportionment only to U.S. corporations and their foreign unincorporated (branch) operations, a method called *domestic combination* [46]. In the above example, if the California subsidiary had a Mexican branch, the California, Maine, and Mexican operations but not the British parent nor the Canadian subsidiary corporations would be included in the unitary business. One state, Illinois, practices *water’s edge* combination and includes only the operations of related affiliates within the U.S. [47] In the above example, if there were an Illinois subsidiary, under water’s edge accounting, only the results of the Maine, California, and Illinois, but not the Mexican, Canadian, or British operations would be subject to combination.

The method of taxation Great Britain finds most egregious is the California method of worldwide unitary combinations. Under that method not only are the factors for the British parent and its worldwide subsidiaries included in the calculation of the apportionment ratios, but the net income of the British parent and all the subsidiaries is also totaled and subject to apportionment. This reaching out by California through the worldwide unitary method to tax indirectly the income of the British parent from operations outside the U.S. is the most aggravating issue [48].

Under *domestic* worldwide apportionment, the net income and apportionment factors of a California parent's subsidiary in Britain are included in the calculation of the apportionment formula. Since the parent must have more than fifty percent control over the British subsidiary before a unitary business is formed, there is less affront to British ownership. However, the British retaliation is clearly directed against this form of unitary tax as well [49]. If the British subsidiary were itself a parent of other subsidiaries, the effect under a domestic worldwide unitary tax on the British corporation would be similar to the worldwide apportionment practiced by California.

Under either method of worldwide apportionment, British corporations which are deemed to be part of a unitary business must supply information concerning their apportionment factors and net income. Although there is no direct tax on the British corporation, California has extended its taxing authority to require British compliance with California tax law [50]. This extension of California tax jurisdiction is seen as overreaching on the part of California [51].

2.3. British Criticism of the Unitary Tax

The British challenge the unitary tax as applied to British corporations on several grounds. First, worldwide combined apportionment differs from the separate accounting method that both the rest of the world and the U.S. federal government use to allocate income [52]. Second, there is an enormous administrative burden attached to complying with the reporting requirements of the unitary method [53]. Third, there are severe inequities of over- and under-taxation caused by the unitary tax which affect British corporations [54]. Finally, the unitary tax inhibits international investment and may encourage Less Developed Countries (LDCs) to adopt such a system [55].

Other criticisms of the unitary tax go beyond the issues raised by British corporations. The unitary tax elevates state taxation to an unwarranted level of international importance [56]. Taxation of foreign income, even indirectly through the apportionment formula, is a national issue and should be the subject of treaties concluded by the federal government [57]. Basic issues of national sovereignty are involved. Uncertainty surrounding the unitary tax also negatively affects international relations [58]. Finally, a foreign corporation lacks an adequate forum to challenge the application of the unitary apportionment laws [59].

3. California Fails to Solve the Unitary Tax Issue

3.1. Proposed California Legislation to Repeal the Unitary Tax

3.1.1. Political Constraints of California Repeal Legislation

At the time the British retaliatory measure was passed, several bills were

pending before the California legislature to repeal the unitary tax [60]. Repeal of the unitary tax, however, has escaped the California legislature for many reasons. Although the revenues from the unitary tax comprise only two percent of California's budget [61], this loss is significant [62]. However, there are ways to recapture some of the lost revenues [63] by taxing foreign dividends [64] or 80–20 corporation income [65].

The various revenue recouping features are constantly being changed in proposed repeal legislation [66]. As passed by the California Senate, S.B. 85 included foreign dividends and 80–20 corporation income in the tax base [67]. Originally, it had excluded both types of income [68]. Still, S.B. 85 failed to pass the Assembly Committee because of an amendment linking repeal to improvements in South Africa's apartheid system [69].

The amendments to S.B. 85 illustrate the political pressure being applied to any repeal in California. U.S. MNCs are opposed to paying more California taxes through repeal of the unitary tax and vigorously oppose inclusion of foreign dividends and 80–20 corporate income [70]. Foreign governments and foreign MNCs tend to support repeal in any form [71], since they would be largely unaffected by inclusion of foreign dividends or 80–20 corporate income [72]. State governments support inclusion of both types of income [73].

3.1.2. Provisions of the Recent California Repeal Legislation

The proposed legislative bill A.B. 1300 (essentially the same as S.B. 85) which received the greatest support during the 1984–85 session, appears on its face to repeal the unitary tax. A.B. 1300 would offer all corporations, including British corporations, an election to be taxed in California under the water's edge method, rather than the existing worldwide method [74]. This option would remove the immediate source of conflict between California and Britain.

The election, however, does not eliminate the worldwide unitary tax, it merely makes it an option. Under prescribed circumstances, the election can be disregarded by the Franchise Tax Board (FTB), the California equivalent of the Internal Revenue Service (IRS) [75]. In addition, corporations can choose not to make an election or request that a previous election be disregarded by the FTB in order to be taxed under the worldwide unitary formula [76].

In order to make a water's edge election under A.B. 1300, a corporation must be willing to pay an annual election fee [77]. The election fee in total is expected to raise approximately twenty percent of the revenue lost through corporations' elections [78]. In reality, the election fee is simply an alternative tax, to which British and other corporations would be subject. Such an election fee amounts to only a partial withdrawal of the worldwide unitary tax.

A.B. 1300 would also include, under the definition of the water's edge, British corporations that are not incorporated in California, but have twenty percent or more of their three apportionment factors in the U.S. or U.S.

possessions [79]. To determine whether a British corporation had twenty percent of its factors in the U.S., the corporation would have to go through the entire administrative process of calculating worldwide unitary apportionment factors, even if the percentage were later found to be less than twenty percent. This calculation would be limited to the British corporate entity itself and not its separately incorporated related entities as under the worldwide method. This provision of A.B. 1300 does not eliminate entirely the potential tax burden or administrative cost of the unitary tax for British corporations.

The repeal features of A.B. 1300 would not become operative until 1987 and then only if the federal government takes action to increase international enforcement of separate accounting [80]. Separate accounting of the financial transactions between U.S. and non-U.S. entities under an election is critical to prevent transfer pricing [81]. The detailed federal actions required [82] make it possible that the election will never become available or will be drastically delayed. The measures also clearly leave California in the position of control over the unitary tax issue [83]. The prospects for a state solution to the unitary tax problem are at best uncertain.

3.2. *Constitutionality of the Unitary Tax Upheld in Container*

A successful constitutional challenge to the California unitary tax as applied to a British or foreign parent could effectively repeal the unitary tax and defuse the British retaliation. The California unitary tax was upheld as applied to a U.S. parent in *Container Corp. of America v. Franchise Tax Board* [84]. The Supreme Court upheld the FTB's characterization of Container Corporation as a unitary business and the application of California's three factor apportionment formula to the U.S. parent and its foreign subsidiaries [85]. The holding only applies to a U.S. parent and offers some hope that unitary apportionment would be struck as applied to a foreign parent [86].

The power of the states to tax under the Tenth Amendment [87] is subject to the constitutional limitations of the Due Process and Commerce Clauses [88]. The Due Process Clause requires there to be a "minimal connection ... between the corporation's activity and the taxing state, and the income attributed to the State for taxing purposes must be rationally related to the income generating values within the taxing state" [89]. Due process challenges are frequently based on claims of extraterritorial taxation [90], the definition of the unitary business [91], the factor apportionment formula [92], or distortion, i.e., a showing that separate accounting would have produced a lower tax than the apportionment formula [93]. The *Container* decision upheld the California unitary tax against all due process challenges [94].

The Commerce Clauses, both interstate and foreign, have been held to prohibit discrimination or the placing of an undue burden on commerce by state tax policies [95]. In *Japan Line, Ltd. v. County of Los Angeles* [96], the

Court struck a local personal property tax under the Foreign Commerce Clause because of double taxation and the possible impairment of federal policy in foreign commerce [97].

Container was distinguished from *Japan Line* on its facts. *Container* was upheld against foreign commerce clause challenges of double taxation because the tax fell on a U.S. corporation, whereas in *Japan Line*, the tax was levied on a foreign corporation [98]. The California unitary tax in *Container* also did not automatically require double taxation; the fact that it may result in disfavored double taxation was permissible [99].

Container was upheld against foreign commerce clause attacks that the California law prevented uniformity in U.S. foreign policy [100]. In *Japan Line*, the tax contradicted "consistent international practice and express federal policy" [101]. The Court found the California taxing statute "[n]either implicates foreign policy issues which must be left to the Federal Government [n]or violates a clear federal directive" [102]. The most important foreign policy implication, retaliation by foreign trading partners, was not anticipated, because among other reasons [103] the incidence of the tax was on a domestic corporation [104].

Since Britain has initiated retaliation against the application of the unitary tax to British corporations, there is some reason to believe that a foreign-parent case before the Supreme Court would succeed. Due process arguments would not be significantly stronger for a foreign-parent than a domestic-parent case. The foreign commerce clause arguments above would, however, take on new force as applied to a foreign parent. Both the double taxation and the federal foreign policy arguments were buttressed on the parent being a U.S. corporation [105].

Although the commerce clause arguments could prevail, in cases where foreign corporations have attempted to raise the issues, the courts have denied standing to sue [106]. Also, as in any judicial proceeding, time plays a factor as to when a case could reach the Supreme Court and whether the Court is willing to grant certiorari. The Court is also limited to the issues presented in the particular case. Thus, a solution to the California unitary tax issue is unlikely to be achieved by Supreme Court adjudication.

4. A Federal Solution to the Unitary Tax Issue

A federal solution to the unitary tax problem could take many forms. The US-UK Convention originally provided a prohibition on the unitary tax as applied to British corporations through the treaty mechanism [107]. Federal studies and recommendations have been made by legislative and executive committees, most recently by the President's Working Group on the Unitary Tax Issue. The most current federal attempt to resolve the unitary tax issue is

the Treasury proposal, which encourages state repeal through federal incentives. The more direct step of federal legislation prohibiting the unitary tax beyond the water's edge may now be appropriate.

4.1. Federal Actions Resulting in the President's Working Group on the Unitary Tax Issue

Prior to the negotiation of the US-UK Convention with Britain, the federal government had begun to study the impact of state taxation on interstate and foreign commerce [108]. The Willis Report [109] gave an in-depth analysis of the problems associated with the inconsistent tax practices of the different states. The Willis Report recommended that "international tax policy should be formulated by the federal government and not by the individual states" [110]. In 1977, the House Ways and Means Committee special task force recommended that "federal income tax rules apply to state taxation of foreign source income" [111]. Since 1965, legislation has been introduced annually to conform state and local tax practices and to place limits on the states' power to tax interstate and foreign commerce [112].

Passage of the US-UK Convention in 1979 without a prohibition of the unitary tax again focused the federal government's attention on the issue. Until 1983, however, there was essentially no federal action to change the unitary tax [113]. British threats of retaliation, as well as other international reaction to *Container*, prompted President Reagan to establish a World-Wide Unitary Taxation Working Group (Working Group) in 1983 [114]. The Working Group was composed of representatives of the federal government, the state governments (notably California Governor George Deukmejian), and the business community [115]. The Working Group was "charged with producing recommendations ... that [would] be conducive to harmonious international economic relations, while also respecting the fiscal rights and privileges of the individual states" [116].

4.2. Guiding Principles of the President's Working Group on the Unitary Tax and the Treasury Proposals

The Working Group established two principles. First, it would defer any discussion of preemptive federal legislation for the implementation of its recommendations and rely on voluntary state action [117]. In his transmittal letter of the Working Group Report, though, Secretary of the Treasury Donald T. Regan recommended federal government preemptive legislation "[i]f there are not sufficient signs of appreciable progress by the states in this area by July 31, [1985]" [118].

Second, the Working Group would study the effects of the unitary tax on U.S. as well as foreign corporations [119]. The Working Group seriously

considered six options to resolve the unitary tax issue, but did not reach agreement on any of them. The major stumbling block to agreement on any option was the treatment of foreign dividends and 80–20 corporations [120].

The Working Group report set forth areas of common understanding which apply to the proposed options No. 2 [121] through No. 6 [122]. These common understandings would include a voluntary limitation of a state's use of the unitary tax to the water's edge [123]. The water's edge definition would include foreign corporations operating in the U.S. as unincorporated businesses (branches) which had a minimum threshold of activity in the U.S. [124] Such a definition would eliminate the worst unitary tax problem, taxation of foreign parents and foreign affiliated corporations [125].

The common understandings of the Working Group would allow the states to use the unitary tax if the procedures set forth did not create reasonable results. For example, if a corporation failed to comply with disclosure requirements, a state could reapply the unitary tax [126]. Also, under procedures set out by the Working Group, the IRS would share information received from foreign governments with the states [127], which would require modification of U.S. bilateral tax treaties, including the US–UK Convention [128]. If any foreign government refused to extend information sharing to the states, the states could impose the unitary tax with respect to that country [129]. Failure of separate accounting to clearly reflect income would be another reason for reimposition of a unitary tax [130].

Options two through six in the Working Group report describe different alternative methods of taxing foreign dividends and the treatment of 80–20 corporation income [131]. The differences in these methods would have little impact on any British corporation [132]. The major purposes of the options are to decide policy questions relating to the redistribution of the tax burden once unitary apportionment is ended [133]. The decision how to tax dividends and 80–20 income is related to repeal of the unitary tax but there is no logical relationship between repeal and the proper treatment of these items [134].

On July 8, 1985, the Treasury released proposed unitary tax legislation which would have the same effect on foreign corporations as the Working Group report [135]. The proposed legislation is modeled after the Working Group report recommendations and requires information reporting by MNCs to help the states "improve ... taxation of multinational corporations" [136]. The legislation requires sharing the information with qualified states, i.e., those which do not impose a worldwide unitary tax [137].

4.3. Criticism of the Treasury's Proposal to Solve the Unitary Tax Problem

The Treasury legislation does not provide a comprehensive solution to the unitary tax problem that will answer the British retaliation. Implementation of the information reporting requirements for corporations and the information

sharing with the states are positive steps recommended by the Working Group report to meet state needs if the worldwide unitary tax is to be eliminated. However, the Treasury legislation includes the inadequacies of the Working Group report and fails to preempt state use of the unitary tax beyond the water's edge and to define the water's edge in a consistent manner.

4.3.1. The Treasury Proposal Does Not Include a Clear Federal Prohibition of the Unitary Tax

The Treasury legislation has as its underlying premise that federal action should not preempt state use of the unitary tax. States argue that a federal prohibition of the unitary tax violates the states' right to determine their own tax policy [138]. Although states have the power to tax under the tenth amendment of the Constitution [139], that power is subject to federal restriction when state policy conflicts with the exercise of enumerated federal powers [140]. The respective state interests in tax revenues and the federal interest in maintaining cooperative foreign relations must be balanced [141]. The British retaliation strongly weighs in favor of the federal prohibition of unitary taxation beyond the water's edge under the Foreign Commerce Clause [142]. A federal preemption of the state use of the unitary tax may be politically unpopular, but the federal government has such power [143].

The legislation contains no coercive element to force states to comply with the abandonment of unitary apportionment, only the withholding of the benefits of the new information procedures if states do not follow the Treasury's water's edge limitation [144]. If a state had financial incentives to retain the unitary tax, that state could do so. The Treasury legislation makes abandonment of the unitary tax beyond the water's edge easier by strengthening the enforcement of separate accounting in the international area. It would also make actual implementation of separate accounting to determine U.S. income easier [145]. If there is no clear federal prohibition against worldwide apportionment, states could later decide to return to worldwide apportionment [146].

The Treasury proposal does not express federal opposition to the unitary tax [147]. Foreign governments would not know for certain that the U.S. government is against worldwide apportionment, only that the federal government is willing to aid states that reject it. The U.S. would be required to negotiate bilateral tax treaties with foreign governments for information sharing with non-unitary tax states, but no provision could be included prohibiting state use of the unitary tax [148]. The federal government could not promise future federal action to limit use of the unitary tax since the Treasury proposal clearly evinces its unwillingness to do so.

The lack of a federal prohibition also sends a mixed signal to LDCs [149]. The U.S. government supports the concept and methodology of the worldwide unitary tax by not preempting it. The federal government's action strongly

suggests to LDCs that worldwide unitary apportionment is acceptable, although not preferred by the U.S. The Treasury legislation would encourage LDCs to threaten unitary apportionment in order to obtain international assistance in enforcing arm's length/separate accounting. LDCs could accept the Treasury example and assume that with their own limited federal (LDC) resources, only worldwide apportionment is enforceable.

Until the federal government makes a clear policy statement, foreign corporations and governments will remain uncertain how to respond to the unitary tax issue [150]. If states can choose to become qualified, or to cease being qualified, then worldwide apportionment could either remain for an unforeseeable time of reappear after a short period of withdrawal.

The lack of a federal mandate prevents states from abolishing the unitary tax. Legislatures cannot pass repeal legislation because U.S. corporations can demand linkage of repeal to favorable treatment of foreign dividends and 80–20 corporate income [151]. If a water's edge limit were imposed, it would give a time limit for repeal and break the linkage of repeal to the other issues, which is precisely what the British retaliation was intended to accomplish [152].

4.3.2. The Treasury Proposal Does Not Provide a Consistent Water's Edge Definition

The Treasury legislation includes some foreign home-office corporations in the water's edge group which would still be subject to the unitary tax [153]. This is the same unitary tax principle that prompted British retaliation, that is, the inclusion of foreign corporations' tax information (net income and apportionment factors) by a state in calculating the state corporate income tax liability. Bilateral tax treaty partners of the U.S. would certainly agree that state taxation of the branch activities in the state should be allowed, but reference to the home-office corporation is contrary to the arm's length/separate accounting principle embodied in all U.S. treaties [154].

Lack of a uniform water's edge limitation prevents the U.S. from negotiating consistently with treaty partners. Even if the Treasury legislation were mandatory, the U.S. could not negotiate a uniform arm's length accounting provision for all federal and state taxes. An exception would be required for foreign branches in the U.S., which could subject the foreign home office to unitary apportionment by any state.

A federal adoption of the Treasury legislation's water's edge definition would encourage states to tax foreign branches and their home offices. If a state could subject the foreign home office to unitary taxation *and* be qualified for the federal benefits of the Treasury legislation [155], then the states would certainly keep the option at least open. States, while being qualified, would retain a means of causing tension in the international relations of the U.S.

4.4. *An Alternative Federal Solution to the Unitary Tax Issue*

This Comment proposes a federal solution which includes the strengths of the Treasury proposal, while correcting its weaknesses. The information reporting and sharing requirements suggested by the Treasury are important and necessary components of a federal solution because such requirements allow the states to implement separate accounting as the alternative to the unitary tax [156]. Measures to increase enforcement internationally of arm's length accounting recommended by the Working Group, including the increase of IRS personnel and assistance to the states in performing tax audits [157], should be implemented concurrently.

This proposed federal solution, contrary to the Treasury legislation, would include a prohibition on the use of the unitary tax by the states beyond the water's edge [158]. Such a prohibition is essential to a prompt and complete repeal of the unitary tax [159]. Such a repeal was initiated late in 1985 by Senator Pete Wilson in the Unitary Tax Repealer Act (Repealer Act), which would prohibit the worldwide unitary tax [160]. Any state solution has the potential weaknesses noted in the California repeal legislation [161]. Waiting for state repeal could result in significant delays which are undesirable in light of the British retaliation [162].

The definition of the water's edge included in this Comment's solution would follow the Treasury proposal but would not allow application of the unitary tax to the foreign home offices of unincorporated branches in the U.S. [163]. This consistent definition would ensure that the unitary tax is not applied to any foreign corporation, except to the extent of a foreign corporation's actual activities in a state through an unincorporated branch [164]. This limitation of the unitary tax would satisfy the British and end the retaliation [165]. The Treasury proposal's definition was not followed in Senator Wilson's repealer Act. This bill mandated that branch activities in a state trigger a worldwide unitary tax on the entire foreign corporation including the home office abroad. Such a statutory provision would do nothing to alleviate the proposed retaliation [166].

The federal solution proposed by this Comment would not specify any particular treatment of foreign dividends and 80–20 corporation income [167]. These issues would be left entirely to the individual state legislatures [168]. This recommendation is contrary to the Repealer Act which specifies when domestic corporations (i.e., the 80–20 corporations) should be treated as foreign entities (i.e., the 80–20 corporations) and how foreign dividends are to be taxed [169]. Instead, allowing states to adopt their own tax policies concerning these items of income would leave the states maximum flexibility in determining their state tax policies consistent with the federal foreign policy need to eliminate the unitary tax beyond the water's edge.

Political opposition to the federal legislation proposed by this Comment

would be considerable [170]. States would oppose the federal prohibition [171], and U.S. MNCs would oppose repeal without linkage to other issues [172]. Both the states and U.S. MNCs, though, would have reasons to support this federal legislation package. States could still seek additional revenues by taxing foreign dividends and 80–20 corporations. U.S. MNCs could be persuaded by the British retaliation and the potential loss of ACT credits to take up the related issues on the state level [173].

5. Conclusion

The unitary tax, when applied beyond the water's edge, is an irritant to international relationships with the U.S. The British retaliation shows how seriously the international community objects to the unitary tax. Failure to resolve the unitary tax issue will cause a serious financial loss of ACT credits by U.S. corporations.

A federal solution to the unitary tax problem would be best. The California repeal legislation does not answer all of the British criticisms of the unitary tax, and there is great uncertainty as to the final content and timing of any state solution.

The federal solution proposed by this Comment would defuse the British retaliation and provide a workable framework for state taxation of MNCs. The beneficial information and enforcement objectives of the Treasury proposal would enable the states to effectively apply separate accounting, rather than unitary apportionment. The prohibition of the unitary tax beyond a consistently defined water's edge by the federal government would prevent state application of the unitary tax to any foreign corporation outside the U.S. and would end the British retaliation against the unitary tax.

Notes

[1] Sec. 54, Finance Act 1985, reprinted in New Clause 27, 1985 Finance Bill, 1355 Parl. Deb., H.C. 1014 (1985) [hereinafter cited as Parliamentary Debates].

[2] The six states are: California, Idaho, Alaska, and North Dakota, which apply the unitary tax worldwide to foreign as well as U.S. parent corporations, and Montana and New Hampshire, which apply the unitary tax worldwide only to U.S. corporations, a method called domestic worldwide unitary tax. Wise, *Global Profits Slip Away from the States*, Bus. Wk., Sept. 16, 1985, 80 [hereinafter cited as *Global Profits*]; Tannenwald, *The Pros and Cons of Worldwide Unitary Taxation*, 25 Tax Notes 649, 652 (1984); Rush & Kennedy, *State Revenues That Would Be Lost by Prohibiting Worldwide Unitary Taxation or the "Flakey Data" Capex*, 21 Tax Notes 1036, 1037 (1983).

[3] The unitary tax, or worldwide unitary apportionment, is a method of calculating the income of a multinational corporation (MNC) which is subject to a state's corporate income tax. The state

taxable income results from multiplying an apportionment factor times the worldwide income of the MNC. The apportionment factor used in California is as follows:

$$\frac{\frac{\text{In-State (IS) Property}}{\text{Total(T) Property}} + \frac{\text{IS Payroll}}{\text{T Payroll}} + \frac{\text{IS Sales}}{\text{T Sales}}}{3} \times \frac{\text{Total Corp. Inc.}}{\text{State Tax Inc.}}$$

For each factor labeled Total, the amounts which are considered part of the unitary business throughout the world are used. For each factor labeled In-State, only the factors within the unitary tax state are used. Comptroller General Report, Key Issues Affecting State Taxation of Multijurisdictional Corporate Income Need Resolving, 359–67, GAO/IGD-82–38 (1982) (report to the Chairman, House Committee on Ways and Means) [hereinafter cited as GAO Report].

[4] Parliamentary Debates, *supra* note 1, *passim* (California is clearly considered the most important unitary tax state and the object of the British retaliation).

[5] Miller, *Worldwide Unitary Combination: The California Practice* [hereinafter cited as Miller], in *The State Corporation Income Tax: Issues in Worldwide Unitary Combination* 132, 139 (Charles E. McClure, Jr. ed. 1984) [hereinafter cited as Issues]. See generally *id.*; Cal. Rev. & Tax Code Ann. § 25101–5.

[6] *Statement by Allen Wallis*, 24 Tax Notes 1063, 1063 (1984) (Mr. Wallis wrote as Under Secretary of State for Economic Affairs).

[7] Parliamentary Debates, *supra* note 1, at 1019 (statement of Mr. Grylls).

[8] Parliamentary Debates, *supra* note 1, at 1034 (statement of Mr. Moore).

[9] Office of the Secretary, Department of the Treasury, The Chairman's Report on the World-Wide Unitary Taxation Working Group: Activities, Issues, and Recommendations (1984), reprinted in 24 Tax Notes 581 (1984) [hereinafter cited as Chairman's Report] (state and other representatives agreed to encourage repeal of the unitary tax, although disagreed on other issues); Murray, *Reagan Decision on Unitary Tax Upsets States*, Wall St. J., Nov. 11, 1985, at 2, col. 2 (President Reagan supports repeal) [hereinafter cited as Reagan Decision]; Sheppard, *Unitary Method: California's Foreign Policy*, 27 Tax Notes 1096, 1096 (1985) (California Gov. Deukmejian and his working group favor repeal with certain conditions). But some unitary tax supporters, including small businesses, the California Franchise Tax Board (FTB), and other public interest groups are opposed to repeal of the unitary tax claiming that the unitary tax is the fairest means of taxation. Cal. Senate Office Research Brief, *The Unitary Controversy*, 7, 8, 19 (1984) [hereinafter cited as Calif. Senate Brief].

[10] See *supra* note 7.

[11] Sheppard, *Corporate Clout in Sunshine State Leads to Repeal of the Unitary Method*, 25 Tax Notes 1057, 1057 (1984) (Florida unitary tax repealed; corporate tax rate simultaneously increased).

[12] Solet, *Combination after Container: The Massachusetts Perspective*, 36 Tax Exec. 157, 157–63 (1984).

[13] A.B. 1300 1985–86 Reg. Sess., 1985 Cal. (introduced by Assembly Member Hughes) (companion bill to S.B. 85); S.B. 85, 1985–86 Reg. Sess., 1985 Cal. (introduced by Sen. Alquist). A.B. 5, 1985–86 Reg. Sess., 1985 Cal. See *infra* at notes 60–83 and accompanying text.

[14] See *infra* notes 82–83 and accompanying text.

[15] Federal legislative bills have been introduced annually to limit the states' use of the unitary tax. See, e.g., S. 687, 99th Cong., 1st Sess. (1985) (bill introduced by Sen. Hawkins); S. 1113, 99th Cong., 1st Sess. (1985) (bill introduced by Sen. Mathias).

[16] For a discussion of the original version of Article 9(4), see *Tax Treaties with the United Kingdom, the Republic of Korea, and the Republic of the Philippines: Hearings before the Comm. on Foreign Relations*, 95th Cong., 1st Sess. 317, 318 (1977) (technical explanation of the US–UK Convention) [hereinafter cited as *Hearings on US–UK Convention*]; Staff of the Joint Comm. on

Taxation, Explanation of Proposed Third Protocol to Proposed Income Tax Treaty between the United States and the United Kingdom, 96th Cong., 1st Sess. 1-3 (Comm. Print 1979) [hereinafter cited as the Explanation of the Third Protocol].

[17] Treasury News Release, July 8, 1985, *reprinted in* 28 Tax Notes 309 (1985) (includes Treasury's proposed unitary tax legislation) [hereinafter cited as the Treasury Legislation].

[18] *Id.* at Sec. B, § 6103(d)(4).

[19] Telephone interview with Richard Allen, Economic Counselor of the British Embassy, Washington, D.C. (Nov. 1, 1985) [hereinafter cited as Interview with Allen].

[20] 463 U.S. 159, *reh'g denied*, 464 U.S. 909 (1983).

[21] Tyler, *Government May Retaliate Over U.S. Unitary Tax*, *Fin. Times*, June 22, 1985, at 5 col. 2. Prime Minister Thatcher has personally brought up the issue with President Reagan. Parliamentary Debates, *supra* note 1, at 1022 (quoting Prime Minister Thatcher, "We might be under very severe pressure to take retaliatory action.").

[22] Parliamentary Debates, *supra* note 1, at 1037 (New Clause 27 added to the 1983 Finance Bill). The bill was introduced by Mr. Grylls of the Tory Backbench Trade and Industry Committee. Tyler, *supra* note 21. The government could not resist the pressure from over 250 Members of Parliament from both parties to pass the measure. Parliamentary Debates, *supra* note 1, at 1018, 1037. There was a clear sense of frustration that retaliatory action had to be taken. *Id.* at 1025 (statement by Sir Griffiths). After a similar bill was rejected in 1984, the Members of Parliament felt U.S. corporations had become less concerned over possible retaliation and had ceased to be zealous in their lobbying efforts. *Id.* at 1022 (statement of Mr. Grylls). The retaliation was passed only weeks before the July 31, 1985 deadline set by Secretary of the Treasury Donald T. Regan for the states to have made "appreciable progress" towards abolishing the unitary tax on their own. Chairman's Report, *supra* note 9, at 1. The California legislature was then considering S.B. 85 and companion bill A.B. 1300, repeal amendments. A.B. 1300 and S.B. 85, *supra* note 13.

After the California legislation repeal failed to pass, many expected the British government to delay implementation of the retaliation. *Britain May Give California More Time on Unitary Tax*, *Fin. Times*, Sept. 17, 1984, at 10, col. 1. After President Reagan's announced support of federal legislation, the British did delay implementation, but also gave a deadline: a legislative bill must be submitted in 1985 and passed in 1986. *Reagan Decision*, *supra* note 9. The British retaliation should be considered a serious threat.

[23] Parliamentary Debates, *supra* note 1, at New Clause 217(3), p. 1014. In 1973, the U.K. Instituted an integrated tax system whereby British resident shareholders received a credit against their individual tax liabilities equal to 35/65ths of the Advance Corporation Tax (ACT), which is the regular corporate income tax. U.S. citizens who were non-residents of Great Britain could not obtain any benefit from this credit of ACT. *Hearings on US-UK Convention*, *supra* note 16, at 15 (statement of Hon. Laurence Woodworth). The US-UK Convention provided for a refund to all U.S. shareholders even though not residents of the U.K., retroactive to 1973. This resulted in substantial retroactive payments by the U.K. to U.S. shareholders. *Id.* at 16.

[24] Convention between the United States of America and the United Kingdom for the Avoidance of Double Taxation, Dec. 31, 1975, United States-United Kingdom, 31 U.S.T. 5668, T.I.A.S. No. 9682 (entered into force April 25, 1980) [hereinafter cited as US-UK Convention], *reprinted in* J. Cohen and R. Greenfield, *UK/US Double Tax Treaties Guide: The Text of the 1980 Income Convention with Notes* (1980) [hereinafter cited as the UK/US Tax Guide]. *Id.* at 2.

[25] *Hearings on US-UK Convention*, *supra* note 16, at 13 (statement of Hon. Woodworth, Assistant Secretary of Treasury for Tax Policy).

[26] Corporations that are 10 % or more shareholders of a U.K. corporation, receive half of the ACT, less 5% of the gross dividend (actual dividend plus the refunded ACT). Other shareholders receive all of the ACT, less 15% of the gross dividend, US/UK Convention, *supra* note 23, at art. 10(2)(a)(i)-(ii); UK/US Tax Guide, *supra* note 23, at 44-49.

[27] Parliamentary Debates, *supra* note 1, at 1030; UK/US Tax Guide, *supra* note 23, at 49. Calculation shows a net refund to a U.S. shareholder on a \$120, \$240, or \$480 dividend of \$18, \$37, or \$74. *Id.*

[28] The group of companies is defined as companies “interconnected by common ownership of at least 51 percent of the voting shares of each.” Fiamma, *U.K. Retaliation against Unitary Taxation*, 28 Tax Notes 1137, 1137 (1985); Parliamentary Debates, *supra* note 1, at Supplementary Provisions as to Withdrawal of Tax Credits, sec. 5-(1), p.1017 (definition of a group).

[29] Parliamentary Debates, *supra* note 1, at New Clause 27(4), p. 1014. The percentage of factors present in a unitary tax state that triggers denial of ACT credits is subject to change according to the discretion of the British Treasury. *Id.* The flexibility is to allow the British Treasury a narrow or broad threshold mechanism. The narrowest threshold would apply only to a corporation which has a principal place of business in a unitary tax state. The broadest threshold would apply to any corporation which is subject to tax in a unitary tax state. *Id.* at 1013.

[30] *Id.* at Supplementary Provisions as to Withholding of Tax Credits, sec. 1.-(1), p. 1015. The U.S. also has a similar provision for double-tax retaliatory measures in I.R.C. § 891 (1954) which the U.S. once threatened against France to obtain a bilateral tax treaty. Parliamentary Debates, *supra* note 1, at 1032 (statement of Mr. Hamilton).

[31] *Id.* at Supplementary Provisions as to Withholding of Tax Credits, sec. 1.-(5), p. 1015. The penalty is intended to be proportionately increased such that the after-tax cost remains the same to the offending corporation.

[32] The total amount of ACT credits involved is difficult to estimate. The total of all ACT refunds to U.S. shareholders is between 300 million pounds (\$417 million) and 500 million pounds (\$695 million) annually. *Id.* at 1028.

[33] *Id.* at 1018. The proposed British retaliation has several flaws. First, the 7.5% threshold is illogical. Originally, a 12.5% limit was considered since California's Gross National Product (GNP) is approximately 12.5% of the U.S. GNP. Parliamentary Debates, *supra* note 1, at 1030 (statement of Mr. Hamilton). There is no relationship between California's GNP and the U.S. activities of an MNC. Although more corporations would be included in the retaliation by lowering the percentage to 7.5% *id.*, the limit is arbitrary. Second, the legislation does not limit the retaliation to corporations that have the means to lobby or influence legislation in the unitary tax states. The retaliation applies when no British corporations are even affected by the unitary tax. In the table below, Case 1 indicates that if the parent is British and potentially subject to California's worldwide unitary tax the retaliatory measure does not apply, since the flow of dividends will follow the direction of ownership from the subsidiary to the parent. The retaliation, therefore, does not apply to the situation of greatest concern to the British Parliament. Parliamentary Debates, *supra* note 1, at New Clause 27(1), p. 1014. Case 2 shows that the retaliation would apply to the parent where the British subsidiary corporation has been included in the unitary business. The parent, however, is potentially foreign, or non-U.S., with merely an indirect ability to lobby against the unitary tax. Famma, *supra* note 28, at 1138. Case 3 is similar to Case 2, but no British Corporation is actually affected by the unitary tax. Ownership in the British subsidiary is below 50%, therefore, the British subsidiary is not included in the “unitary business” subject to tax. *See infra* note 49 and accompanying text. ACT credits, which would be available to the parent since the British subsidiary is at least 10% owned, would be denied under the retaliation. *See supra* note 26. Case 4 is the situation the retaliation attempts to address. Then and only then is the U.S. parent corporation in a position to exert lobbying pressure. The retaliation has a high probability of indiscriminately affecting non-U.S. parents, as in Case 2 or 3.

Case	GB Corp. affected	Retal- iation	GB	CA	Affiliated Companies	
					Other US	Non-US
1	yes	no	Parent	Sub	—	—
2	yes	yes	51% Sub	Sub	—	Parent
3	no	yes	10% Sub	Sub	—	Parent
4	no	yes	10% Sub	Sub/ Parent	Sub/Parent	—

[34] The only additional corporations which could be motivated to lobby against the unitary tax are those that now favor the unitary tax, such as Caterpillar Tractor Co. *See* *Chicago Bridge and Iron Co. v. Caterpillar Tractor Co.*, 454 U.S. 1029 (1981) (Caterpillar insisting on using worldwide unitary apportionment). Such corporations prefer the unitary tax because for them it produces a lower tax. Parliamentary Debates, *supra* note 1, at 1023 (statement of Mr. Grylls) (implication that some corporations benefit from the unitary tax); GAO Report, *supra* note 3, at v.

[35] New Clause 27 was explained as having no effect if California repealed its unitary tax. Parliamentary Debates, *supra* note 1, at 1030 (statement of Mr. Hamilton). However, the broad threshold could still be applied to pressure other unitary tax states. *See supra* note 29.

[36] Parliamentary Debates, *supra* note 1, at 1022. Other Members of Parliament indicated a similar indifference whether there was a federal or a state solution. *Id.* at 1022 (statement of Sir Griffiths) (federal solution); *id.* at 1028 (statement of Mr. Blair) (state solution).

[37] The 45 states which impose a corporate tax have a myriad of different definitions of taxable income. For a general comparative understanding of state practices, see GAO Report, *supra* note 3, at 59–67 (“Inventory of State Income Tax Provisions as of December 31, 1981”).

[38] *See supra* note 2. There is a strong presumption that income is earned in direct proportion to the factors of the apportionment formula. *See generally* Miller, *supra* note 5.

[39] McClure, Introduction, in Issues, *supra* note 5, at xvii.

[40] Tannenwald, *supra* note 2, at 651.

[41] *Id.*; GAO Report, *supra* note 3, at 4 (general criteria for most states include: percentage of ownership, sharing of centralized services, and the type and number of interentity transactions). Corporations generally favor a definition of a unitary business as one in which “basic operating functions are substantially interdependent.” States prefer a broader definition based on “control, as manifested by stock ownership....” *Id.* at ii. For an excellent discussion of the California factors, see Miller, *supra* note 5, at 140–42.

[42] Miller, *supra* note 5, at 136–40.

[43] Miller, *supra* note 5.

[44] GAO Report, *supra* note 3, at 31.

[45] Tannenwald, *supra* note 2, at 651.

[46] *Id.* at 652.

[47] *Id.*; Rush & Kennedy, *supra* note 2, at 1037.

[48] Parliamentary Debates, *supra* note 1, at 1019 (statement of Mr. Grylls).

[49] The legislation itself applies a water’s edge definition. *Id.* at Supplementary Provisions as to Withdrawal of Tax Provisions, sec. 5-(1), p. 1018.

[50] Foreign governments complain that this violates the nexus or relationship standard of taxation if the British corporation itself does not have a business presence in California. Carlson & Galper, *Water’s Edge Versus Worldwide Unitary Combination* [hereinafter cited as Carlson & Galper], in Issues, *supra* note 5, at 25.

[51] For a sympathetic American view, see Sen. Hawkins introducing S. 687: “[I]magine our concern if a U.S. citizen was required to add together the income of his or her relatives everywhere

in the world in order to compute his or her taxable income – even though the relative's [*sic*] income was derived from foreign investment." 131 Cong. Rec. S3174 (daily ed. March 9, 1985).

[52] All other national taxing authorities use arm's length accounting which treats each entity as a separate accounting unit for tax purposes. This "separate accounting" method generally prevents any state from taxing income earned outside its jurisdiction and thereby creating double taxation. A detailed understanding of the principles of reallocation of items of income and deduction between related entities to reflect an arm's length basis can be found in I.R.C. § 482 and the regulations thereunder. I.R.C. § 482 (1954); Treas. Reg. § 1.482-1 (1962).

California argues that unitary apportionment is necessary to prevent transfer pricing among related corporations under separate accounting. Transfer pricing results when an MNC uses the inter-entity prices for goods and services to shift income to lower tax jurisdictions. Since California taxes corporate income at a rate of 9% (Vaughan, *State Taxation and Economic Development*, in State Taxation Policy 68, 69 (N. Barker ed. 1983)) compared to other states' rates ranging from *none* (Texas) to 12% (Minnesota) *id.*, there would be an incentive to have income "appear" in Texas rather than in California or Minnesota. The British debates in Parliament prior to the passage of the retaliation reflect an understanding of the transfer pricing problem. Parliamentary Debates, *supra* note 1, at 1023–24 (statement of Dr. Marek) ("there cannot [be] two systems (separate accounting and apportionment) working side by side [internationally].").

Double taxation can also occur under arm's length/separate accounting. U.S. Federal income taxes are based on both income from U.S. sources as well as the worldwide income of any U.S. resident. Carlson & Galper, *supra* note 50, at 17. Under the U.S. resident rules, income from another country previously taxed under that country's source rules could result in double taxation. This type of double taxation is not prevented by separate accounting, but is provided for in other ways. I.R.C. § 901, for instance, provides a credit for income taxes paid to another country. I.R.C. § 901 (1954). States do not give any credit for previously taxed income. Also, the US–UK Convention provides for a Mutual Agreement Procedure for negotiating allocations of income and deductions where the arm's length/separate accounting methods still result in double taxation. US–UK Convention, *supra* note 24, at art. 25. There is no similar procedure for eliminating double taxation under unitary taxation at the international level with other countries, or even on a national level with other unitary tax states.

In theory, if every taxing authority would adopt unitary apportionment instead of separate accounting, double taxation would also be avoided. All taxing authorities would also have to agree on standards for unitary apportionment, the definition of a unitary business, and the calculation of the apportionment formula. Changing the standards of virtually every taxing authority and bilateral tax treaty would be an enormous task. Milton, Comments on Miller [hereinafter cited as Milton] 182, in Issues, *supra* note 5.

[53] Burdens resulting from compliance include the conversion of foreign currencies, lack of uniform state rules of laws, and disclosure of sensitive information.

Various illustrations and research have attempted to show the relative cost of the administrative burden to the additional tax collected by the unitary method. One study found the unitary administrative burden equaled 16% of the tax liability for most corporations. GAO Report, *supra* note 3, at 16. A foreign-controlled corporate group with 3,000 separate entities similarly showed an 188b/ rate. *Hearings on US–UK Convention*, *supra* note 16, at 200.

For an analysis of five different theoretical methods for translating foreign currency financial information into U.S. dollars, see Miller, *supra* note 5, at 152–56. California has chosen to require the Profit and Loss Method, whereby net income is translated at the current exchange rate. *Id.* at 155. The apportionment factors of sales and payroll are translated using the same currency rates as net income. Property, however, must be converted at the currency rates in existence when the property was acquired. *Id.* at 133–34. California procedures are familiar to U.S. corporations with controlled foreign corporations (CFCs), as defined in I.R.C. § 957 (1954), required to report sub-part F income under Section 960 and the Treasury Regulations thereunder. I.R.C. § 960

(1954); Treas. Regs. § 1.964-1(d)(3) (1964). However, British corporations are *not* required to prepare this information for their subsidiaries and hence the additional administrative burden is greater.

The financial information must be converted into U.S. accounting and state tax accounting standards from the foreign accounting standards. For example, a British parent with unitary subsidiaries in France and Germany would have to convert first the financial information from the original national accounting methods into U.S. accounting, then further translate the information into the state statutory scheme. For an understanding of the various state tax accounting rules, see *supra* note 2. If the British parent had subsidiaries in two unitary tax states, the last step of the conversion process would have to be performed according to each state's tax accounting rules. GAO Report, *supra* note 3, at 59-68.

There are also concerns that the apportionment factor information could require sensitive disclosures. EMI, a British corporation which owned Capitol Industries, refused to supply the necessary apportionment information because it concerned classified materials. Revealing the information could have violated EMI's pledge of secrecy to the British government. *EMI, Inc. v. Bennet*, 681 F.2d 1107 (9th Cir. 1982), *on remand sub nom. EMI, Ltd. v. Bennet*, 560 F. Supp. 134 (N.D. Cal. 1982), *cert. denied*, 459 U.S. 1087 (1983); Parliamentary Debates, *supra* note 1, at 1019 (statement of Mr. Grylls) (expressing concern over the EMI case).

[54] Britain complains that unitary taxation often results in overtaxation due to variable wage rates, property values, and sales factors in different countries. Parliamentary Debates, *supra* note 1, at 1019 (statement of Mr. Blair); *Hearings on US-UK Convention*, *supra* note 16, at 34 (Sony Corporation has complained of the negative effects of high U.S. labor costs in the apportionment formula); *Unitary Group's Task Force Begins to Assess Proof of Harm*, 21 Tax Notes 821 (1983); Carlson & Galper, *supra* note 50, at 24.

The states are also accused of manipulating the apportionment formulas to allocate the maximum amount of income to their state. *Id.*; Milton, *supra* note 52, at 183. One such claimed manipulation is the inclusion by California of only taxable compensation in the payroll factor. Since many countries require large payments by corporations for social costs which are *not* taxable to the employee, the foreign payroll is dramatically reduced. Peterson, Comments on Miller, in Issues, *supra* note 5, at 167, 168. Other reasons sometimes mentioned for over or undertaxation are: the use of U.S. tax basis for domestic information and audit information, when converted statements are unavailable) for foreign information, *Hearings on US-UK Convention*, *supra* note 16, at 34; differences between U.S. and foreign pollution control and safety laws, Carlson & Galper, *supra* note 50, at 24; use of before tax income, Milton, *supra* note 52, at 187; and inclusion of the entire income of a partially owned subsidiary, as does California, Laboe, Comments on Miller [hereinafter cited as Laboe], *supra* note 5, at 173, 175-79. If a corporation has foreign income, but California losses, it is possible through apportionment to result in a tax liability to California. *Unitary Tax Group's Task Force Begins to Assess Proof of Harm*, 21 Tax Notes 821 (1983) (Alcan Aluminum, Ltd. was assessed taxes for years in which it sustained a loss in California).

[55] McClure, *The State Corporation Income Tax: Issues in Worldwide Unitary Combination*, 22 Tax Notes 1129, 1133 (1984) [hereinafter cited as *State Corporation Income Tax*].

[56] Countries representing 84% of the direct investment in the U.S. have voiced their "deep concern" over this "serious obstacle" to international trade and investment. Mr. Seike Tazaki, leader of Keidanren (Japanese Federation of Economic Organizations) and chairman of C. Itoh & Co., said over 40 Japanese manufacturers in the U.S. will not invest in a unitary tax state, may leave unitary tax states, or may require promises by other states never to adopt a unitary tax. *Japan, Inc. Reinforces Complaints about the Unitary Method*, 22 Tax Notes 653, 653 (1984); see also Parliamentary Debates, *supra* note 1, at 1034 (Sir Eldon Griffiths, "[B]ad for business, bad for trade....", at 1024-25) (Mr. Moore, "[I]t will distort investment decisions."); GAO Report, *supra* note 3, at ii.

[57] Parliamentary Debates, *supra* note 1, at 1019, 1022 (statement of Mr. Grylls).

[58] *Id.* at 1035 (statement of Mr. Grylls).

[59] For a discussion of the standing problem, see Note, *State Worldwide Unitary Taxation: The Foreign Parent Case*, 23 Colum. J. Transnat'l L. 445, 474–79 (1985).

[60] S.B. 85, A.B. 5, A.B. 300, *supra* note 13.

[61] *Global Profits Slip Away from the States*, Int'l Bus. Wk., Sept. 16, 1985, at 80.

[62] The stated revenue loss from A.B. 1300 (S.B. 85) in 1986–87, 1987–88, and 1988–89 tax years was \$52, 179, and 255 million respectively. California Senate Revenue and Taxation Committee, Digest of A.B. 1300, Prepared for Hearing Sept. 9, 1985, at 429 [hereinafter cited as Digest of A.B. 1300]. The revenue issue is especially acute in California, which experienced the taxpayer revolt from 1978–82. Tannenwald, *supra* note 2, at 653.

[63] Digest of A.B. 1300, *supra* note 62, at 431–32 (considerations whether to balance the revenue impact of the bill).

[64] Dividends, whether domestic or foreign, received by a unitary business in a unitary state such as California, are ignored for purposes of worldwide apportionment. Instead of taxing income when received by the California entity, the unitary method effectively apportions all income when earned. When worldwide apportionment is discontinued, the question is whether to tax the foreign dividends received by a unitary business in the U.S. California Senate Office of Research Brief, *supra* note 9, at 15–18.

[65] 80–20 corporations are corporations incorporated in the U.S., but whose predominant activity is 80% or more outside the U.S. The definition of 80% activity outside the U.S. could be based on either the U.S. Federal income tax definition as to source of income or based on the states' apportionment factors. Chairman's Report, *supra* note 9, at 586–87; Digest of A.B. 1300, *supra* note 62, at 429. Business considers 80–20 corporations as essentially the same as foreign corporations. States tend to view them as U.S. corporations. Chairman's Report, *supra* note 9.

[66] Calif. Senate Brief, *supra* note 9, at 14, 19.

[67] Sheppard, *Unitary Method Legislation Moves in California*, 28 Tax Notes 21, 21 (1985) [hereinafter cited as *Unitary Method Legislation Moves*]; Calif. Senate Brief, *supra* note 9, at 12–14. S.B. 85 went through other legislative changes. In the Senate, S.B. 85 was amended to include an election fee to compensate for some of the lost revenue. *Unitary Method Legislation Moves*, *supra*. S.B. 85 in the Assembly Revenue and Taxation Committee lost its weighted sales factor which was part of the Senate version designed to benefit companies investing in California; it was also amended to exclude 67% of foreign dividends apportioned to California and to include a slightly higher election fee. Sheppard, *California Unitary Method Repeal Bill Reported Out of Committee*, 28 Tax Notes 933, 933 (1985) [hereinafter cited as *Repeal Bill Reported Out*].

[68] *Unitary Method Legislation Moves*, *supra* note 66, at 21; Sheppard, *Unitary Method: California's Foreign Policy*, 27 Tax Notes 1096, 1096 (1985) [hereinafter cited as *Unitary Method: California's Foreign Policy*].

[69] Sheppard, *California's Unitary Method: The Never-Ending Story*, 28 Tax Notes 1161, 1161 (1985) [hereinafter cited as *Never Ending Story*].

[70] *Id.* at 1162. The California Business Council (CBC), representing 90 domestic MNCs is strongly opposed to inclusion of dividends and 80–20 income in the tax base. Domestic MNCs feel that inclusion would put them at a competitive disadvantage vis-à-vis foreign corporations. *Id.*

[71] Sony, Kocera, and Shell Oil are foreign corporations that have contributed significantly to repeal lobbying efforts. *Id.*

[72] Interview with Allen, *supra* note 19.

[73] The various positions of domestic and foreign MNCs and foreign and state governments are clearly stated in Calif. Senate Brief, *supra* note 9, at 19.

[74] A.B. 1300, *supra* note 13, at art. 1.5, p. 14, 21 (creating new para. 25110). The election is for an initial period and must be renewed annually. *Id.* at 21 (creating new para. 25111).

[75] *Id.* at 18 (creating new para. 25110(d)). The circumstances under which the FTB could disregard an election are where the filing corporation has failed to comply with information requirements (spreadsheets), the return fails to prevent evasion of income taxes, and the corporation fails to cooperate in the administration of the California corporate tax. *Id.*

[76] *Id.* at 21 (creating new para. 25111(e)).

[77] *Id.* at 29–30 (creating new para. 25110(d)). The fee is calculated as twenty-one thousands of the electing corporation's property, payroll, and sales in California. *Id.*

[78] Digest of A.B. 1300, *supra* note 62, at 426. Total election revenues from the election fee for the first three years of implementation are expected to total \$131 million. The total revenues lost through the election are estimated at \$617 million. *Id.*

[79] A.B. 1300, *supra* note 14, at art. 1.5 (creating new para. 25110(a)(7)). The provision is a clear contrast to the US–UK Convention, which limits the federal taxation of “permanent establishments”, US–UK Convention, *supra* note 24, at art. V, to the profits of such establishments determined under the separate accounting method. US–UK Convention, *supra* note 24, at art. VII; UK/US Tax Guide, *supra* note 24, at 32.

[80] A.B. 1300, *supra* note 36, at art. 1.5 (creating para. 25115(a)(2)).

[81] See *supra* note 52 and accompanying text.

[82] A.B. 1300 requires the following action by the federal government: “making available domestic disclosure spread sheets for each company; federal funding for a designated agency for making audit referrals to the various states; procedures for the states to examine data on foreign transactions of multinationals; an increase of the IRS budget over four years of \$72 million for international audits.” Digest of A.B. 1300, *supra* note 62, at 425; A.B. 1300, *supra* note 13, at Art. 1.5 (creating new para. 25115(a)(2)).

[83] The British government believes that any bill which passes could be amended later. Interview with Allen, *supra* note 19. Britain was in favor of A.B. 1300, Digest of A.B. 1300, *supra* note 62, at 433, although it had many reservations. Interview with Allen, *supra* note 19. A.B. 5, although receiving much less support than S.B. 85 or A.B. 1300, *Repeal Bill Reported Out*, *supra* note 67, at 933, contained certain provisions that would correct the problems indicated in notes 60–73 and accompanying text.

1. Paragraph 25115(a) makes the option effective immediately, not subject to federal action, for tax years beginning *after* Jan. 1, 1985.

2. Paragraph 25115(b) removes the election option for *new* businesses if certain federal actions to enforce separate accounting are not forthcoming. Under A.B. 5, however, existing elections would remain in force.

3. Paragraph 25111(a) makes an election binding for all tax years, unless either disregarded by the FTB or permission is granted by the FTB.

4. Paragraph 25110(a)(7) includes unincorporated businesses in the definition of the water's edge group, but *not* the operations of the foreign home office corporation. This would prevent application of unitary apportionment to the British home office. The U.S. operations would be a “deemed” subsidiary and separate accounting would be applied to determine its taxable income as distinct from the home office.

A.B. 5, *supra* note 13.

[84] 463 U.S. 159.

[85] *Id.* at 179.

[86] See Note, *supra* note 59, at 445.

[87] U.S. Const. Amend. X, see *infra* notes 97–106.

[88] GAO Report, *supra* note 3, at 2.

[89] Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980); see also GAO Report, *supra* note 3, at 2; State Taxation of Multinational Corporations, Report A-92, at 3 (Washington D.C. ACIR, Apr. 1983) [hereinafter cited as ACIR Report].

[90] *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982) ("a State may not tax on value earned outside its borders."); *Container Corp.*, 463 U.S. at 164 (a state income tax may not "result ... in extraterritorial values being taxed" (quoting *Butler Bros. v. McColligan*, 315 U.S. 501, 507 (1942))); Hellerstein, *State Taxation under the Commerce Clause: the History Revisited* 53, 64 [hereinafter cited as Hellerstein], in *Issues*, *supra* note 5.

[91] *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 221, 207–27 (1980); *Container Corp.*, 463 U.S. at 164 ("[T]he Constitution imposes no single formula on the States" (citing *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 445 (1940))). The focus in recent cases has been the state definition of a unitary business and the application to the facts of a specific case. In *Container Corp.*, 463 U.S. at 166, the Court summarized the requirements for a definition of a unitary business:

1. Some business must be done in the taxing state (citing *Exxon Corp.*, 447 U.S. at 220);
2. Some bond of ownership or control must unite the purported unitary business (citing *ASARCO, Inc.*, 458 U.S. at 316–17);
3. Out-of-state activities must be related in some concrete manner to the in-state activities, "beyond the mere flow of funds arising out of a passive investment." *Id.* (citing generally *ASARCO, Inc.*, 458 U.S. at 317; *Mobil Oil*, 445 U.S. at 438–42).

[92] Hellerstein, *supra* note 90, at 65. Compare *Mobile Oil*, 445 U.S. 425, and *Exxon Corp.*, 447 U.S. 207 (where unitary businesses were upheld) with *ASARCO*, 458 U.S. 307, and *Taxation and Revenue Dept. of N.M. v. F.W. Woolworth Co.*, 458 U.S. 354 (1982) (where no unitary businesses were found). Under the Due Process Clause, the apportionment formula must be fair and related to how income is generated. The "three factor formula has become something of a benchmark against which other apportionment formulas are judged." *Container Corp.*, 463 U.S. at 169, 170.

[93] *Container Corp.*, 463 U.S. at 184; *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 135 (1931) (striking application of one factor apportionment formula because "the income attribut[able] to [the state is] out of all appropriate proportion to the business transacted ... in that state.") Separate accounting showed 22% of the income attributable to the taxing state rather than 90% under the apportionment formula. *But see Exxon Corp.*, 447 U.S. at 222–23 (separate accounting does not take into account intangible results of related businesses and is not constitutionally required).

[94] *Container Corp.*, 463 U.S. at 162–80.

[95] *Id.* at 170; GAO Report, *supra* note 3, at 2.

[96] *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979).

[97] *Id.* at 448.

[98] *Container Corp.*, 463 U.S. at 187–88.

[99] *Id.* at 193.

[100] *Japan Line, Ltd.*, 441 U.S. at 448.

[101] *Container Corp.*, 463 U.S. at 190.

[102] *Id.* at 194.

[103] *Id.* at 195. The other reasons were similar to the arguments supporting the lack of constitutionally objectionable double taxation. See *supra* notes 98–99 and accompanying text.

[104] *Id.*

[105] *Id.*

[106] *ASARCO*, 458 U.S. 307; *Shell Petroleum N.V. v. Graves*, 409 F.2d 593 (9th Cir.), *cert. denied*, 464 U.S. 1012 (1983); *Alcan Aluminum Ltd. v. Department of Revenue*, 724 F.2d 1294 (7th Cir. 1984). For a discussion of the standing issue, see Note, *supra* note 59, at 474–79.

[107] UK/US Tax Guide, *supra* note 24, at 41. At the time, only California, Alaska, Oregon, Montana, and North Dakota applied the unitary tax on a worldwide basis although other states were moving in that direction. *Hearings on US–UK Convention*, *supra* note 16, at 72 (statement of John Lobdell, President of the Multi-State Tax Commission).

During negotiations with Britain over the US-UK Convention, the limitation on the states' use of the unitary tax was considered a significant bargaining tool. The U.S. wanted to obtain a

substantial concession from the British: a refund to U.S. shareholders of the British ACT credit. US-UK Convention, *supra* note 24. On the basis of this quid pro quo, the U.S. agreed to Article 9(4) restricting states' rights to impose the unitary tax on British corporations, and the British agreed to refund ACT to U.S. shareholders. US-UK Convention, *supra* note 23, at art. 10(2). Although initially the US-UK Convention including the unitary tax prohibition passed the Senate Foreign Relations Committee, it subsequently failed to receive the required two-thirds vote in the Senate until the prohibition of the unitary tax was removed. Explanation of the Third Protocol, *supra* note 16, at 1.

Article 9(4) caused significant objections in the U.S. from advocates of states' rights. California, speaking on behalf of states, strongly criticized the Treasury for negotiating away such a significant source of state revenue "without any consultation with any state." *Hearings on US-UK Convention*, *supra* note 16, at 95 (position paper of the California FTB). Also, Senator Church, on behalf of the states, criticized the fact that so significant a state right as the power to tax should be limited by a treaty negotiated with one country. *Id.* at 21 (only the Senate, not the House, votes on the passage of treaties, therefore, states' rights advocates are limited in their lobbying efforts.)

When the Senate ratified the Convention subject to Sen. Church's reservation removing the prohibition of the unitary tax, Britain was outraged. *See supra* note 1. Although the British Parliament accepted the US-UK Convention without the prohibition of the unitary tax, it required assurances that the "unitary tax problem would be solved." *Id.* Subsequently, correspondence between Britain and the U.S. showed Britain's continuing concern over the issue. *Id.* Finally, in the absence of any comprehensive resolution of the unitary tax problem during the five years since the US-UK Convention went into effect, the British Parliament passed the retaliatory measure.

[108] *E.g.*, The Willis Report, Four Volume Study on Foreign Source Income, H.R. Rep. No. 1480, 88th Cong., 2d Sess. (1964), H.R. Rep. No. 565, 89th Cong., 1st Sess. (1965), H.R. Rep. No. 9523, 89th Cong., 1st Sess. (1965) (Washington D.C., USGPO, 1964 and 1965) [hereinafter cited as Willis Report]; GAO Report, *supra* note 3, at 6.

[109] Willis Report, *supra* note 108.

[110] *Id.* at 1155 (H.R. Rep. No. 952).

[111] ACIR Report, *supra* note 89, at 2 citing House Comm. on Ways and Means, Recommendations of the Task Force on Foreign Source Income 30 (USGPO 1977).

[112] ACIR Report, *supra* note 89, at 3. The most recent bills have been S. 687 and S. 1113. *See supra* note 15. The states have been actively trying to harmonize state taxation policy in order to prevent congressional intervention. In 1957, the National Conference of Commissioners on Uniform State Laws agreed on a set of principles to clarify state income tax policy, the Uniform Division of Income for Tax Purposes Act (UDITPA). GAO Report, *supra* note 3, at 10; U.S. General Accounting Office, IRS Could Better Protect U.S. Tax Interests in Determining the Income of Multinational Corporations (1981). UDITPA does not provide any solution to the unitary tax problem but merely attempts to standardize the states' practices and reduce the unnecessary confusion and overlapping of laws. GAO Report, *supra* note 3, at 10. Significant freedom was left to the states to choose among several options. In 1981, 25 states followed UDITPA, but each with variations. Other state-oriented groups, such as the Multi-State Tax Commission (MTC) formed in 1966, have similarly failed to deal with the unitary tax and related international retaliation. *Id.* at 11.

[113] Parliamentary Debates, *supra* note 1, at 1020 (statement of Mr. Grylls).

[114] *Id.* at 1020-22; Chairman's Report, *supra* note 9, at 583.

[115] Chairman's Report, *supra* note 9, at 587 (Annex A - Members of Working Group).

[116] *Id.* at 583 (quoting the Treasury Department news release announcing formation of the group).

[117] *Id.*

[118] *Id.* at 581.

[119] *Id.* Three options were proposed by representatives of the states' interests, two options were prepared by business interests, and one was offered by the Advisory Commission on Inter-governmental Affairs. *Id.* at 589–95.

[120] *Id.* at 584.

[121] Option one provided for an alternative activities tax in lieu of unitary apportionment for a foreign-based MNC. This state proposal would tax in-state corporations with foreign parents at an elective alternative activities tax rate on in-state activities (payroll, property, and sales) instead of being taxed on a worldwide basis. The alternative rate would be the comparable rate of similar industries in-state. *Id.* at 589–90.

[122] *Id.*; see *infra* notes 131–34 and accompanying text.

[123] *Id.* at 590.

[124] *Id.* The minimum threshold of activity would be having either “more than 20 percent of their average payroll, property, and sales; or at least \$10 million of payroll and/or property and/or sales and/or purchases assignable to a location in the United States pursuant to the law of the taxing state.” *Id.* at n.3. “A foreign corporation which does not have taxable nexus in any state ... would not be included in a water’s edge group.” *Id.* This inclusion of foreign branches in the definition of the water’s edge is similar to A.B. 1300. See *supra* note 79.

[125] Chairman’s Report, *supra* note 9, at 590. Only those entities listed are included in the domestic water’s edge group and would be subject to the unitary tax. Foreign corporations are *not* listed. *Id.* at 595 n.1.

[126] *Id.* at 590.

[127] *Id.* at 590–91.

[128] The US–UK Convention, Art. 26(1) allows the exchange of information received by the IRS with other persons only for the purpose of “assessment, collection, enforcement, or prosecution in respect of taxes which are subject to this Convention.” US–UK Convention, *supra* note 16, at art. 26 (emphasis added). State taxes are not covered by the Convention, as modified by the Third Protocol. *Id.* at art. 2 (the reference in Art. 2(1) to taxes of “political subdivisions or local authorities” is negated by the omission of state income taxes in art. 26(2)(a), *Id.* at arts. 2(1), 26(2)(a)).

[129] See Chairman’s Report, *supra* note 9, at 590–91. Cases such as *EMI, Inc.* would not cause reapplication of the unitary tax since the information requirement excludes military or defense secrets. Chairman’s Report, *supra* note 9, at 596 n. 13; *EMI, Inc. v. Bennet*, 681 F.2d 1107 (9th Cir. 1982), *on remand sub nom.* *EMI, Ltd. v. Bennet*, 560 F. Supp. 134 (N.D. Cal. 1982), *cert. denied*, 459 U.S. 1087 (1983); Parliamentary Debates, *supra* note 1, at 1019 (statement of Mr. Grylls) (expressing concern over the EMI case).

[130] Chairman’s Report, *supra* note 9, at 590. The assumption implicit in the Working Group Report is that the enhancements to separate accounting, which are also part of the Working Group’s common elements, would allow separate accounting to clearly reflect income. Treasury Legislation, *supra* note 17, at 309, 311 n.3.

[131] Option two would tax net foreign dividends received by a U.S. corporation. Option three would tax gross foreign dividends (adding to net dividends the foreign tax credit gross-up under § 78, I.R.C. § 78(1954) but would include foreign factors in the apportionment formula. Foreign dividends would only be subject to apportionment under *ASARCO*, 458 U.S. 307; *Woolworth*, 458 U.S. 354; and *Mobile Oil*, 445 U.S. 425, if the foreign corporation payor was part of the unitary business. See *supra* note 92. Option four would exclude foreign dividends from the tax base unless the ownership percentage in the foreign corporation was less than 80%, in which case 15% of the dividends would become taxable. Option five would include net foreign dividends as foreign source and would apportion some foreign source income to U.S. operations under certain circumstances. Option six would require foreign dividends to be treated the same as U.S. dividends. Chairman’s Report, *supra* note 9, at 591–95.

[132] Options three and five would require certain administrative reporting relating to the dividends by the British corporation of factor information to the U.S. parent; it would, however, be very limited in comparison to the burden of worldwide apportionment. *See supra* note 131.

[133] *See supra* notes 63–65 and accompanying text.

[134] Chairman's Report, *supra* note 9, at 581.

[135] Treasury Legislation, *supra* note 17, at 309.

[136] *Id.*

[137] *Id.* at 311.

[138] *Reagan Decision*, *supra* note 9. *See generally* GAO Report, *supra* note 3, at 22–25.

[139] *Gibbons v. Ogden*, 22 U.S. 1, 198 (1824).

[140] *Container Corp.*, 463 U.S. at 170, 185–94; *cf. Zschernig v. Miller*, 389 U.S. 429 (1968) (determining when state estate taxes interfere with federal foreign policy under the Commerce Clause).

[141] *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 329 (1977) (“delicate adjustment between national interest in free and open trade and the legitimate interest of the individual States in exercising their taxing powers.”).

[142] ACIR Report, *supra* note 89, at 7. The report found that after balancing the respective state and federal interests, there was no need for federal preemptive legislation since there was *no sign of foreign retaliation*. *Id.*; *see supra* note 103 and accompanying text.

[143] *Hearings on US–UK Convention*, *supra* note 16, at 22 (statement of Sen. Church).

[144] Treasury Legislation, *supra* note 17, at Sec. 2. § 6103(d)(1), p. 313.

[145] Under a water's edge limitation, the states still apply apportionment to the U.S. operations, excluding the income of foreign corporations. However, separate accounting is still critical in separating the income of a given affiliated group which includes foreign corporations between the U.S. and foreign entities. If separate accounting were to fail to clearly reflect income, then profits could be artificially left abroad and never be subject to a state income tax. *See supra* note 59.

[146] Treasury Legislation, *supra* note 17, at Sec. 2. § 6103(d)(4)(E) & (F), p. 313. The definition of a qualified state does not require a permanent decision not to use worldwide apportionment. A state could become unqualified in a subsequent year simply by reimposing a unitary tax worldwide. *Id.*

[147] There is a general statement that a qualified state does not use worldwide unitary apportionment, although there is in turn no statement that being qualified or non-qualified is to be preferred as a matter of federal policy. *Id.*

[148] *See supra* notes 78–129 and accompanying text. Britain has indicated its willingness to renegotiate the information sharing sections of the US–UK Convention. Interview with Allen, *supra* note 19.

[149] *See McClure*, *supra* note 55, at 1133.

[150] *See supra* note 58 and accompanying text.

[151] *See supra* notes 64–65 and 67 and accompanying text.

[152] *See supra* notes 34–35 and accompanying text.

[153] *See supra* note 124 and accompanying text.

[154] *See supra* note 145 and accompanying text.

[155] *See supra* note 124 and accompanying text.

[156] *See supra* notes 126–29 and accompanying text.

[157] *See supra* note 130 and accompanying text.

[158] *See supra* note 144 and accompanying text. S. 687 and S. 1113, *supra* note 15, would impose a federal prohibition.

[159] *Reagan Decision*, *supra* note 9.

[160] S. 1974, 96th Cong., 2d Sess. § 7518(a) (1985).

[161] *See supra* notes 81–83 and accompanying text.

[162] *Id.*

[163] *See supra* note 124 and accompanying text; *Statement by the Business Representatives on the Worldwide Unitary Taxation Working Group*, 24 Tax Notes 1064, 1064 (1984) (recommending a deemed subsidiary approach).

[164] *See supra* note 124 and accompanying text.

[165] Interview with Allen, *supra* note 19.

[166] S.1974, *supra* note 160, at 7518(c)(2)(D).

[167] Essentially all current legislative proposals to end unitary taxation include the foreign dividend and 80-20 corporation issues, including S. 1113 and S. 687, *supra* note 15; S.B. 85, A.B. 1300, and A.B. 5, *supra* note 13.

[168] The Treasury proposal did *not* include any preferred or mandatory treatment of the related issues. *See supra* notes 135-37 and accompanying text.

[169] S.1974, *supra* note 160, at § 7518(a).

[170] *Reagan Decision*, *supra* note 9.

[171] *Id.*

[172] *Cf. Never Ending Story*, *supra* note 69, at 1162 (U.S. corporations oppose California repeal legislation S.B. 85 because of its unfavorable treatment of foreign dividends and 80-20 corporations).

[173] *See supra* notes 30-35 and accompanying text.